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ORIGIN EUR-12

INFO OCT-01 ISO-00 FRB-03 TRSE-00 AID-05 CIAE-00 COME-00

EB-07 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03 SP-02

CIEP-01 LAB-04 SIL-01 OMB-01 L-03 H-02 PA-01 USIE-00

PRS-01 CEA-01 EA-07 IO-11 NEA-10 SSO-00 NSCE-00 NSC-05

SS-15 INRE-00 /111 R

DRAFTED BY EUR/RPE:WCLARK:LW

APPROVED BY EUR/RPE-DLAMB

FRB-DHOWARD

TREASURY-JABBOTT

EB/OMA-PBALABANIS (INFO)

----- 075012

O R 282315Z JAN 76

FM SECSTATE WASHDC

TO USMISSION OECD PARIS IMMEDIATE

INFO AMEMBASSY LONDON

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E.O. 11652: N/A

TAGS: OECD, UK

SUBJECT: EDRC REVIEW OF THE UK, JANUARY 29

REF: OECD PARIS 2123; EDR(76)3

1. WE ARE IN GENERAL AGREEMENT WITH THRUST OF SECRETARIAT ANALYSIS, ALTHOUGH IT MIGHT REPRESENT A LOWER BOUNDARY OF WHAT WE CONSIDER LIKELY OUTCOME FOR 1976. WE WOULD EXPECT SOME SMALL POSITIVE GROWTH OF GNP MEASURED YEAR OVER YEAR RATHER THAN NO CHANGE (PARA 48 REFDOD). EXPORTS MAY BE UP A BIT MORE THAN THE ONE AND THREE QUARTERS PERCENT YEAR-ON-
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YEAR RISE SEEN BY THE SECRETARIAT AND GROSS FIXED INVEST-

MENT MAY NOT FALL AS FAR AS 4.5 PERCENT, GIVEN THE SIZE OF NORTH SEA OIL OUTLAYS AND THE EXPECTED IMPROVEMENT IN RESIDENTIAL HOUSING.

2. IN REGARD TO THE "NEW INDUSTRIAL STRATEGY", WE WELCOME ANNOUNCED POLICY FOR REINVIGORATING AND MODERNIZING INDUSTRIAL STRUCTURE. A SUCCESSFUL POLICY WILL REQUIRE NOT ONLY MORE INVESTMENT IN THE PRIVATE SECTOR BUT ALSO A SYSTEM OF INCENTIVES WHICH ALLOWS INDUSTRY TO BE MORE ADAPTABLE TO CHANGING CIRCUMSTANCES. WHAT IS THE GOVERNMENT'S TIMETABLE FOR IMPLEMENTATION ON THE NEW INDUSTRIAL STRATEGY? WHAT IS THE SCALE OF GOVERNMENT RESOURCES WHICH WILL BE DEVOTED TO THE NEW POLICY TO INSURE ITS SUCCESS?

3. WE UNDERSTAND FROM PRESS COMMENTS THAT ONLY ABOUT 25 PERCENT OF UNIONIZED WORKERS HAVE NEGOTIATED CONTRACTS SINCE THE WAGE RESTRAINT PROGRAM WAS INITIATED LAST SUMMER. SOME OF THE SETTLEMENTS HAVE BEEN FOR LOWER PAID WORKERS FOR WHOM THE 6 POUND LIMIT REPRESENTS CLOSE TO A 20 PERCENT WAGE INCREASE. TO WHAT EXTENT, THEREFORE, HAS THE DEACCELERATION OF INFLATION BEEN DUE TO THE WAGE RESTRAINT PROGRAM RATHER THAN THE GENERAL EFFECTS OF RECESSION?

4. WHAT IS THE LIKELY PATH OF GOVERNMENT SPENDING DURING THE FISCAL YEAR 1976-77 BEGINNING IN APRIL? THE BUDGET LAST YEAR CALLED FOR CUTS IN PROJECTED SPENDING LEVELS TO BEGIN WITH FISCAL YEAR 1976-77. IN THE CURRENT FISCAL YEAR, HOWEVER, EXPENDITURES IN VOLUME TERMS SEEM TO BE LARGER THAN BUDGETED. ARE THE EXPENDITURE CUTS NOW BEING DISCUSSED FOR FY 1976-77 EXPECTED TO SLOW DOWN THE GROWTH IN REAL GOVERNMENT SPENDING FROM THE PRESENT HIGH BASE, OR WILL THE CUTS REDUCE SPENDING BACK TO THE VOLUME LEVELS PROJECTED LAST MARCH?

5. RE PARA 12 REFTTEL, 1975 WHITE PAPER CALLED FOR GROWTH IN GOVERNMENT EXPENDITURES OF 2.75 PERCENT IN FY 1977-78 AND 1978-79. HOWEVER, CHANCELLOR'S LETTER OF APPLICATION TO IMF FOR NEW UK DRAWING HAD TARGET OF HOLDING REAL GOVERNMENT EXPENDITURES CONSTANT IN THESE FISCAL YEARS.

6. THE GROWTH RATE OF THE MONEY SUPPLY HAS BEEN KEPT LIMITED OFFICIAL USE

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BELOW THE RATE OF GROWTH OF MONEY INCOMES AS AN ANTI-INFLATIONARY POLICY TOOL. IN THE LAST QUARTER OF 1975 M1 AND M3 CHANGED HARDLY AT ALL. HOWEVER, THE CHANCELLOR'S LETTER TO THE IMF CONTAINS AN ESTIMATE OF GROWTH IN DOMESTIC CREDIT WHICH WOULD PERMIT AN ACCELERATION IN THE MONEY SUPPLY, RAISING THE POSSIBILITY THAT BY THE END OF 1976 THE MONEY SUPPLY COULD BE RISING FASTER THAN MONEY INCOMES. WE WOULD THUS BE INTERESTED IN ANY LIGHT UK DEL COULD SHED

ON THE OUTLOOK OR TARGET FOR GROWTH IN THE MONEY SUPPLY
DURING THE COMING YEAR.

7. WHAT IS THE UK DEL'S BEST ESTIMATE OF THE COMBINED
EFFECT OF INFLATION AND STERLING DEPRECIATION ON THE COM-
PETITIVENESS OF BRITISH EXPORTS IN RECENT YEARS? SOME
COMMENTS BY BRITISH AUTHORITIES INDICATE THAT THESE TWO
EFFECTS HAVE CANCELLED EACH OTHER OUT AND UK EXPORTS ARE
ABOUT AS COMPETITIVE NOW AS THEY WERE WHEN STERLING WAS
FLOATED IN JUNE 1972. HOWEVER, SOME INDEPENDENT ESTIMATES
(SUCH AS BY MORGAN GUARANTY) OF PRICE-ADJUSTED TRADE-
WEIGHTED EXCHANGE RATES SHOW THAT THE DEPRECIATION OF
STERLING HAS NOT FULLY REFLECTED THE UK'S INFLATION SINCE
1973.

8. SECRETARIAT EXPECTED SAVINGS RATIO WILL FALL ABOUT
ONE PERCENTAGE POINT IN 1976 (PARA 43 REFDOC). IS THIS IN
LINE WITH HMG EXPECTATIONS ALSO? KISSINGER

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC DEVELOPMENT, GNP, ECONOMIC REPORTS, GOVERNMENT REACTIONS
Control Number: n/a
Copy: SINGLE
Draft Date: 28 JAN 1976
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: morefirh
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1976STATE021503
Document Source: CORE
Document Unique ID: 00
Drafter: WCLARK:LW
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D760033-0174
From: STATE
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1976/newtext/t19760112/aaaaaker.tel
Line Count: 133
Locator: TEXT ON-LINE, ON MICROFILM
Office: ORIGIN EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 3
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 76 OECD PARIS 2123
Review Action: RELEASED, APPROVED
Review Authority: morefirh
Review Comment: n/a
Review Content Flags:
Review Date: 22 APR 2004
Review Event:
Review Exemptions: n/a
Review History: RELEASED <22 APR 2004 by BoyleJA>; APPROVED <17 MAY 2004 by morefirh>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
04 MAY 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: EDRC REVIEW OF THE UK, JANUARY 29
TAGS: ECON, UK, OECD, EDRC
To: OECD PARIS
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006